86-515

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

JUDY'S FOODS, INC., *et al.*,
Petitioners,

v.

A&B FOOD SERVICES CORP., *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Excessive Fines Clause of the Eighth Amendment bars the imposition, in a civil case, of punitive damages that are as much as 35 times greater than the actual damages found.

2. Whether the Due Process Clause bars the imposition of punitive damages absent evidence that satisfies the "clear and convincing" standard of proof.

PARTIES TO THE PROCEEDING AND STATEMENT PURSUANT TO SUP. CT. RULE 28.1

The following were appellants in the court of appeals and are petitioners in this Court: Judy's Foods, Inc., General Care Corporation, Marvin P. Friedman and Joel Gordon. Judy's Foods, Inc. is a wholly-owned subsidiary of General Care Corporation which, in turn, is a wholly-owned subsidiary of Hospital Corporation of America.

The following were appellees in the court of appeals and are respondents in this Court: MC Management Corporation No. 4, MC Management Corporation No. 7 and A&B Food Services Corporation.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Judy's Foods, Inc., General Care Corporation, Marvin P. Friedman and Joel Gordon petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINION BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-6a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on June 3, 1986. A petition for rehearing was denied on August 4, 1986 (App. B, *infra*, 7a-8a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS INVOLVED

1. The Eighth Amendment provides, in pertinent part:

> "[N]or [shall] excessive fines [be] imposed * * *."

2. The Fourteenth Amendment provides, in pertinent part:

> "No state shall * * * deprive any person of * * * liberty, or property, without due process of law."

STATEMENT OF THE CASE

1. In 1976, petitioner General Care Corporation established a wholly-owned subsidiary corporation in Nashville, Tennessee, known as Judy's Foods, Inc., to enter the "fast-food" franchise business. Petitioners Marvin P. Friedman and Joel Gordon were the principal officers of both General Care and Judy's. App. A, *infra*, 2a. Respondents are three corporations established by two Philadelphia businessmen—Agostine Malerba and Burton Cooperberg—to operate restaurants under franchises from Judy's. *Id.*

Respondents' restaurants did not prosper and eventually were closed. Thereafter, respondents filed a diversity action in the United States District Court for the Middle District of Tennessee, claiming that petitioners had breached the contractual agreements between the parties and had engaged in actual fraud, fraudulent concealment, promissory fraud, constructive fraud, and negligent misrepresentation in the course of their dealings with Malerba.[1] Petitioners contended that respondents' lack of success was due to respondents' own mismanagement and to adverse economic conditions.

Following a trial, the jury exonerated petitioners on respondents' claims of actual fraud, promissory fraud,

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[1] Respondents' complaint also included a claim for conspiracy which was dismissed on petitioners' motion for a directed verdict.

negligent misrepresentation and breach of contract, but found petitioners liable for fraudulent concealment and constructive fraud, and awarded $44,000 in compensatory damages. Additionally, the jury awarded respondents $850,000 in punitive damages.[2] The district court denied petitioners' motion for judgment n.o.v. App. A, *infra*, 3a.

2. On appeal, petitioners argued, *inter alia*, that (1) the district court erred in failing to instruct the jury that fraud must be proven by clear and convincing evidence; and (2) the punitive damages award should be reduced or vacated because Tennessee law requires a reasonable relationship between compensatory and punitive damages and the ratio in this case—of as much as 35 to 1—was far beyond the range generally approved by Tennessee courts.[3]

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[2] These aggregate awards were broken down as follows: for respondent A&B Food Services, $20,000 in compensatory damages and $100,000 in punitive damages; for respondent MC Management Corp. No. 4, $14,000 in compensatory damages and $375,000 in punitive damages; for respondent MC Management Corp. No. 7, $10,000 in compensatory damages and $350,000 in punitive damages. Punitive damages were assessed against petitioners in the following amounts: $50,000 against Judy's and its parent, General Care; $500,000 against Marvin Friedman; and $300,000 against Joel Gordon.

[3] Petitioners also contended that they should not have been found liable for failing to disclose certain information about their business because the decision not to disclose that information was a legitimate exercise of business judgment. Viewed in the light most favorable to respondents, the evidence showed that petitioners failed to disclose: (1) that another fast-food franchisor, Wendy's, threatened to sue Judy's for allegedly copying the Wendy's format; (2) that the ensuing litigation with Wendy's contributed to Judy's decision to change its format; (3) the financial performance of restaurants owned and operated by Judy's itself; (4) the overall financial performance of Judy's; (5) the return of franchise fees to other franchisees; and (6) adverse business circumstances reported to the board of directors.

The trial judge instructed the jury that in ordinary business relationships there is no duty of disclosure and that such a duty

The court of appeals affirmed. App. A, *infra*, 1a-6a. The court did not specifically address petitioners' claim concerning the appropriate standard of proof. With respect to petitioners' claim that the punitive damages awards were excessive and disproportionate, the court of appeals remarked that "Tennessee has never adopted the reasonable relationship test." *Id.* at 5a. The court noted that the Tennessee Supreme Court has held that the reasonableness of punitive damages should be measured against the egregiousness of the defendant's acts and the financial worth of the defendant. *Id.* Under this standard, the court of appeals was "constrained to conclude that the punitive damage awards were not 'contrary to all reason.' " *Id.*

3. On April 22, 1986, several weeks before the court of appeals issued its opinion in this case, this Court decided *Aetna Life Insurance Co. v. Lavoie*, 106 S.Ct. 1580 (1986). In *Aetna*, the appellants challenged an award of punitive damages on the ground, among others, that the award was impermissible under the Excessive Fines Clause of the Eighth Amendment and that the lack of sufficient standards governing the imposition of punitive damages awards contravenes the Due Process Clause of the Fourteenth Amendment. *Id.* at 1589. Although this Court vacated the lower court's judgment on a different

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arises only where there is a fiduciary relationship between the parties. II Tr. 274-75. Although most courts that have considered the issue have held that the franchisor-franchisee relationship is not, as a matter of law, a fiduciary one, *e.g.*, *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, 485 (5th Cir. 1984); *Murphy v. White Hen Pantry Co.*, 691 F.2d 350, 354-55 (7th Cir. 1982); *Power Motive Corp. v. Mannesmann Demag Corp.*, 617 F. Supp. 1048, 1052 (D. Colo. 1985); *Amoco Oil Co. v. Cardinal Oil Co.*, 535 F. Supp. 661, 666-67 (E.D. Wis. 1982), the trial court permitted the jury to decide whether there was a fiduciary relationship between the parties. But for this finding, there would have been no wrong for which punitive damages could have been awarded.

ground, it took note of the appellants' constitutional arguments and observed that they "raise important issues which, in an appropriate setting, must be resolved." *Id.*

In light of this Court's statement in *Aetna*, petitioners lodged a supplemental brief with the court of appeals on June 3, 1986, asserting that there was a constitutional dimension to petitioners' arguments about the reasonableness of the punitive damages award and the appropriate standard of proof for punitive damages. On that same day, however, the court of appeals issued its opinion affirming the district court's judgment. Petitioners again presented the constitutional issues in a timely petition for rehearing. The court of appeals denied the petition for rehearing, noting that the issues raised therein "were fully considered upon the original submission and decision of the case." App. B, *infra*, 7a-8a.

REASONS FOR GRANTING THE PETITION

This case presents two important constitutional questions that warrant review by this Court. The first question is whether the Eighth Amendment prohibits the award of excessive and disproportionate punitive damages in civil cases. The second question is whether due process requires that punitive damages may be awarded only if the plaintiff has proved by "clear and convincing evidence" that the defendant acted with the requisite culpability.

Just last Term, in *Aetna Life Insurance Co. v. Lavoie*, 106 S.Ct. 1580 (1986), this Court was confronted with arguments raising very similar constitutional questions concerning the imposition of punitive damages. The Court in *Aetna* noted that the constitutional arguments "raise important issues which, in an appropriate setting, must be resolved." *Id.* at 1589. This case provides the Court with "an appropriate setting" in which to resolve these important issues.

I. The Eighth Amendment Prohibits the Imposition of Excessive and Disproportionate Punitive Damages in Civil Cases.

There can be no question that the Eighth Amendment requires a penalty to be proportionate to the offense. *Solem v. Helm*, 463 U.S. 277, 284-88 (1983). The appropriate question, therefore, is whether the Eighth Amendment applies to punitive damages. The Amendment, by its terms, expressly prohibits "excessive fines." Both the history of this provision and recent decisions of this Court support the conclusion that this prohibition extends to excessive awards of punitive damages in civil cases.[4]

A. *Punitive Damages Are Subject to the Eighth Amendment Because They Are Penal In Nature.*

This Court has recognized that "[s]ome punishments, though not labeled 'criminal' by the State, may be sufficiently analogous to criminal punishments in the circumstances in which they are administered to justify application of the Eighth Amendment." *Ingraham v. Wright*, 430 U.S. 651, 669 n.37 (1977). Thus, when a law "imposes a disability for the purposes of punishment—that is, to reprimand the wrongdoer, to deter others, etc.—it has been considered penal." *Trop v. Dulles*, 356 U.S. 86, 96 (1958) (plurality opinion) (footnote omitted). *Accord*, *Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 168-69 (1963) (listing factors relevant to a determination of whether a particular sanction is "penal" in character).

The Court has defined punitive damages in plainly "penal" terms: they are " 'private fines levied by civil juries to punish reprehensible conduct and to deter its

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[4] In addition, a growing body of academic commentary has questioned the constitutionality of unrestrained punitive damages. *See, e.g.*, Jeffries, "A Comment on the Constitutionality of Punitive Damages," 72 Va. L. Rev. 139 (1986); Wheeler, "The Constitutional Case for Reforming Punitive Damages Procedures," 69 Va. L. Rev. 269 (1983).

future occurrence.'" *International Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 48 (1979), *quoting Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974). Similarly, Tennessee has consistently identified punitive damages as a sanction not meant to enrich the plaintiff but to punish the defendant, to deter the defendant and others from repeating his misconduct, and to make a public example of the defendant. *E.g., Huckeby v. Spangler*, 563 S.W.2d 555, 558-59 (Tenn. 1978); *Tipton County Bd. of Educ. v. Dennis*, 561 S.W.2d 148, 152 (Tenn. 1978).

Since punitive damages serve a penal function, they should be constrained by the limits imposed by the Eighth Amendment. As we demonstrate below, the history of the Eighth Amendment also compels this conclusion.

B. *History Demonstrates that the Excessive Fines Clause Applies to Punitive Damages.*

The Eighth Amendment was taken nearly verbatim from the Virginia Declaration of Rights, which in turn was taken verbatim from the English Bill of Rights of 1689. *Solem*, 463 U.S. at 285 n. 10; R. Perry, *Sources of Our Liberties* 235, 247, 303 (1959); A. Howard, *The Road From Runnymede* 205-07 (1968). Thus the Framers intended the Eighth Amendment to provide at least as much protection as its English counterpart provided. *Solem*, 463 U.S. at 286.

The English Bill of Rights of 1689 stated that "'excessive Baile ought not to be required nor excessive Fines imposed * * *.'" 1 Wm. & Mary, sess. 2, ch. 2, *quoted in Solem*, 463 U.S. at 285. By this time English law had long required that monetary penalties must be in proportion to the offense. *See* Jeffries, *supra*, 72 Va. L. Rev. at 154-57; Granucci, "'Nor Cruel and Unusual Punishments Inflicted': The Original Meaning," 57 Cal. L. Rev. 839, 847 (1969). This freedom from excessive penalties was first enshrined in Magna Carta, three chapters of which

were "devoted to the rule that 'amercements' may not be excessive." *Solem*, 463 U.S. at 284 (footnote omitted).

An amercement was a monetary penalty that could be assessed for a variety of wrongs in civil as well as criminal actions. *See* 3 W. Blackstone, *Commentaries on the Laws of England* 376, 398 (facsimile ed. 1979); 4 *Id.* at 372. "Every tort, nay, every cause of civil action," was punishable by amercement. 2 F. Pollock & F. Maitland, *The History of English Law* 519 (2d ed. 1898). *See* Jeffries, *supra*, 72 Va. L. Rev. at 154-55.

Amercements were the forerunners of the "fines" that were the subject of the English Bill of Rights in 1689.[5] Accordingly, when the English Bill of Rights proscribed excessive fines, it proscribed excessive monetary penalties, whether in criminal or civil proceedings. Moreover, the Excessive Fines Clause of the English Bill of Rights encompassed penalties that served the same purposes as are served by punitive damages, which were not judicially recognized until the Eighteenth Century.[6] Because the English bar against excessive fines applied to

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[5] Fines developed because of the procedural rule in Magna Carta that only " 'honest men of the neighbourhood' " were authorized to impose an amercement. Magna Carta, ch. 20 (1215), *quoted in* Jeffries, *supra*, 72 Va. L. Rev. at 155. The effect of this rule was to deprive judges (and the king) of their power to impose amercements. The judges, however, retained the power of imprisonment, and used it to exact monetary penalties. Rather than be incarcerated, a defendant could "make fine with the king." 2 F. Pollock & F. Maitland, *supra*, at 517. The difference between an amercement and a fine thus was wholly procedural, and a fine could be imposed for civil as well as criminal offenses.

Before 1689, other substitutes for amercements developed which resembled punitive damages insofar as the amounts were more than compensatory and were paid to the plaintiffs, rather than to the king. 2 F. Pollock & F. Maitland, *supra*, at 522; *see also* 4 W. Holdsworth, *A History of English Law* 536-37 (3d ed. 1927).

[6] Exemplary damages were first identified by name in 1763. *Huckle v. Money*, 2 Wils, K. B. 205, 95 Eng. Rep. 768 (1763).

civil fines, it therefore follows that the Excessive Fines Clause of the Eighth Amendment also applies to punitive damages.

C. *The Eighth Amendment Requires That Punitive Damages Be Proportionate to the Defendant's Wrong.*

As noted earlier, the bedrock principle embodied in the Eighth Amendment is that bails, fines and other punishments must be proportionate to the offense. "When the Framers of the Eighth Amendment adopted the language of the English Bill of Rights, they also adopted the English principle of proportionality." *Solem*, 463 U.S. at 285-86 (footnote omitted). Indeed, "[t]he constitutional principle of proportionality has been recognized explicitly in this Court for almost a century." *Id.* at 286 (footnote omitted). Since "the Eighth Amendment imposes 'parallel limitations' on bails, fines, and other punishments," *id.* at 289, *quoting Ingraham*, 430 U.S. at 664, fines are subject to the limitation of proportionality. And since punitive damages are "fines" within the meaning of the Excessive Fines Clause, punitive damages cannot be disproportionate to the offense.

The punitive damages awarded in this case are disproportionate and therefore excessive under the Eighth Amendment. To begin with, the aggregate punitive damages award of $850,000 is more than nineteen times the aggregate compensatory award of $44,000. The punitive damages awarded to respondents are, respectively, 35, 27, and five times the compensatory award each received. Thus, the punitive damages awards are grossly disproportionate to respondents' injuries.[7]

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[7] Courts in a number of jurisdictions have expressly required proportionality between the amount of punitive damages and the amount awarded for actual damages. *E.g., Maxey v. Freightliner Corp.*, 722 F.2d 1238, 1242, *modified on other grounds*, 727 F.2d 350, 353 (5th Cir. 1984) (applying Texas law); *Stambaugh v. In-*

The punitive damages awards are disproportionate by other standards of measurement as well. For example, under the general statute governing false statements against the federal government, a convicted defendant is subject to a fine not exceeding $10,000. *See* 18 U.S.C. § 1001. By the same token, the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961 *et seq.* authorizes a private plaintiff to institute a civil action, § 1964, at which treble damages (plus attorney's fees) may be recovered if the defendant can be shown, *inter alia*, to have engaged in "racketeering" activity. § 1961(1). As four Justices of this Court recently observed, a civil RICO action places a defendant in the position of "facing a tremendous financial exposure [producing] a strong interest in settling the dispute." *Sedima, S.P.R.L. v. Imrex Co.*, 105 S.Ct. 3275, 3294 (1985) (Marshall, J., dissenting). Yet this "tremendous financial exposure" of treble damages pales by comparison to the fine which has been imposed on petitioners here.

In short, this case is an appropriate vehicle for resolving one of the important constitutional questions left open in *Aetna*—whether the Eighth Amendment prohibits excessive punitive damages awards in civil cases.

II. The Due Process Clause of the Fourteenth Amendment Mandates that a Defendant's Culpability For Punitive Damages Must Be Established By "Clear and Convincing Evidence."

The district court instructed the jury that respondents had to prove their fraud claims only by a preponderance of the evidence (II Tr. 258-59). By its silence on the matter, the court indicated that the same burden of proof applied to the question whether petitioner's conduct was sufficiently egregious to warrant imposition of punitive damages (II Tr. 300-01). However, the Due Process

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ternational Harvester Co., 106 Ill. App. 3d 1, 435 N.E.2d 729, 747 (1982), *rev'd on other grounds*, 102 Ill.2d 250, 464 N.E.2d 1011 (1984).

Clause required the court to instruct the jury that it could award punitive damages only if it found by "clear and convincing evidence" that petitioners had acted recklessly, willfully, or wantonly.

The Due Process Clause requires the use of an appropriate standard of proof in a particular proceeding to ensure that the factfinder engages in a properly intensive search for the truth. *Addington v. Texas*, 441 U.S. 418, 423-25 (1979). As the Court has observed, *id.* at 423:

> The function of a standard of proof, as that concept is embodied in the Due Process Clause and in the realm of factfinding, is to "instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication." *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring). The standard serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision.

In determining the appropriate standard of proof in any case, "[t]hree distinct factors" must be considered: "the private interests affected by the proceeding; the risk of error created by the State's chosen procedure; and the countervailing governmental interest supporting use of the challenged procedure." *Santosky v. Kramer*, 455 U.S. 745, 754 (1982), *citing Mathews v. Eldridge*, 424 U.S. 319, 335 (1976). Application of these factors demonstrates the need for a heightened standard of proof on the question whether a defendant's conduct warrants an award of punitive damages. *See* Wheeler, *supra*, 69 Va. L. Rev. at 291-93, 296-98, 311-14.

First, the interests at stake for a defendant on the issue of liability for punitive damages are generally much greater than on the issue of liability for compensatory damages. As noted earlier, exemplary awards are penal in nature; one of the purposes of punitive damages in

most jurisdictions, including Tennessee, is to punish the defendant for willful or wanton misconduct. Thus, the imposition of punitive damages stigmatizes a defendant and brands him as an egregious wrongdoer. In a commercial case such as this one, an award of punitive damages marks the defendant as one not to be trusted in future transactions. *See Wisconsin v. Constantineau*, 400 U.S. 433, 436-37 (1971) (government-imposed stigma entitles party to due process). In addition, punitive damages expropriate the defendant's property in excess of the amount necessary to compensate the injured plaintiff.

Second, the risks entailed by the possibility of error are not shared equally by both parties, as in an ordinary civil action for compensatory damages. Where punitive damages are at stake, the defendant faces the possibilities of social stigma and of an onerous money judgment. On the other hand, once the plaintiff has recovered compensatory damages, he already has been made whole; so far as the plaintiff is concerned, therefore, punitive damages provide a windfall. Accordingly, the adverse consequences of an erroneous finding in the punitive damages context are much greater for a defendant than for a plaintiff.

Third, the state has an interest in a heightened standard of proof because punitive damages awards serve essentially the same functions as criminal penalties—punishment and deterrence. For this reason, the state has an interest in seeing that such penalties are meted out in a rational and consistent manner.[8]

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[8] Where, as here, a defendant is alleged to have engaged in fraudulent conduct, many jurisdictions require the plaintiff to satisfy the clear and convincing evidence standard in order to establish *any* liability for fraud, let alone liability for punitive damages arising from such fraud. Thus, as the Court observed in *Addington*, a heightened standard of proof is typically used "in civil cases involving allegations of fraud or some other quasi-

The preponderance of the evidence standard does not adequately balance these interests. Because, under that standard, a plaintiff need only tip the scales in its favor "ever so slightly" (II Tr. 264-65), a defendant in an action seeking punitive damages is vulnerable to a massive monetary judgment and to stigmatization based on an uncertain determination of liability. The clear and convincing standard, by contrast, requires the jury to make a more considered finding that a defendant has acted recklessly, willfully, or wantonly. Under the latter standard, a plaintiff would be entitled to recover punitive damages "only if [it] could place in the ultimate factfinder an abiding conviction that the truth of its factual contentions are 'highly probable.'" *Colorado v. New Mexico*, 467 U.S. 310, 316 (1984). This heightened standard reduces substantially the risk of an erroneous judgment with severe consequences.

The clear and convincing standard also would promote the state's interest in a fair and effective system for imposing civil penalties. Because this higher standard requires juries to scrutinize the evidence more carefully, it would avoid situations in which punitive damages awards are based on only minimal differences in proof. By requiring a more definitive finding that the defendant has engaged in egregious conduct, the clear and convinc-

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wrongdoing by the defendant. The interests at stake in those cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof." 441 U.S. at 424. *See also, Steadman v. SEC*, 450 U.S. 91, 105 (1981) (Powell, J., dissenting). In this case, the courts below determined that petitioners could be held liable for constructive fraud and fraudulent concealment on the basis of evidence satisfying the lesser preponderance of the evidence standard. It was all the more critical, therefore, that the heightened standard of proof be applied before petitioners could be found liable for punitive damages.

ing standard would help to ensure that punitive damages satisfy the state's interests in punishment and deterrence.[9]

The Court has already stated that the application of the Due Process Clause to the procedures by which punitive damages are awarded is an issue worthy of review. This case offers the Court an appropriate opportunity to consider this important issue.

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[9] Without specifically considering whether the clear and convincing standard is constitutionally required, several courts have concluded that punitive damages may be imposed only where there is clear and convincing evidence of willful and wanton misconduct. *Acosta v. Honda Motor Co.*, 717 F.2d 828, 839 (3d Cir. 1983) (applying Virgin Islands law); *Tuttle v. Raymond*, 494 A.2d 1353, 1362-63 (Me. 1985); *The Traveler's Indemnity Co. v. Armstrong*, 442 N.E.2d 349, 358-63 (Ind. 1982); *Wangen v. Ford Motor Co.*, 97 Wis.2d 260, 294 N.W.2d 437, 457-58 (1980). *Cf. Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 851 (2d Cir. 1967). In addition, several states have enacted legislation imposing this higher standard of proof in actions seeking punitive damages. *See* Minn. Stat. Ann. § 549.20 (West Supp. 1986); Mont. Code Ann. § 27-1-221(2) (1985); Or. Rev. Stat. § 30.925 (1981). In one jurisdiction, moreover, a plaintiff seeking punitive damages must meet the reasonable doubt standard. Colo. Rev. Stat. § 13-25-127(2) (1973). *See Tri-Aspen Constr. Co. v. Johnson*, 714 P.2d 484, 486 (Colo. 1986). These recent judicial and legislative actions reflect a growing realization that a heightened standard of proof is required in the punitive damages context as a matter of fundamental fairness.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PETER J. NICKLES *
K. GREGORY TUCKER
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Dated: September 26, 1986

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 85-5527

A & B FOOD SERVICES CORPORATION, M.C. MANAGEMENT CORPORATION #7, M.C. MANAGEMENT CORPORATION #8, AB MANAGEMENT CORPORATION #8,
Plaintiffs-Appellees,

v.

JUDY'S FOODS, INC.; GENERAL CARE CORPORATION; MARVIN FRIEDMAN; AND JOEL GORDON,
Defendants-Appellants.

On Appeal from the United States District Court
for the Middle District of Tennessee

Decided and filed June 3, 1986

Before: KRUPANSKY and GUY, *Circuit Judges*; and HOLSCHUH, *District Judge*

PER CURIAM. Defendants/appellants Judy's Foods Inc., General Care Corporation, Marvin Friedman and Joel Gordon (collectively referred to as "defendants")

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* Hon. John D. Holschuh, United States District Judge, Southern District of Ohio, sitting by designation.

appealed the jury verdict and denial of their motion for judgment notwithstanding the verdict in this diversity action.

In 1976, General Care Corporation, a Tennessee corporation, formed Judy's Foods, Inc. ("Judy's") for the purpose of owning, operating and franchising limited menu fast food restaurants under the name "Judy's Homestyle Hamburgers and Fixins." The individual defendants, Marvin Friedman and Joel Gordon, were officers, directors, and members of the Executive Committee of both Judy's and General Care Corporation.

Judy's solicited Agostine Malerba ("Malerba"), to become its franchisee in the greater Philadelphia area. In May, 1978, Malerba, relying upon the representations of Judy's, executed an agreement with Judy's, which granted to Malerba an option to franchise a total of fifteen Judy's restaurants in the geographical area of Philadelphia. Malerba assigned one-half of his interest in the franchisee agreements to his business partner, Buddy Cooperberg ("Cooperberg") and they in turn formed the three plaintiff corporations, A & B Food Services Corporation, M.C. Management Corporation # 4 and M.C. Management Corporation # 7 to construct and operate two Judy's franchises in Philadelphia. Malerba and Cooperberg were the sole stockholders of the corporate plaintiffs, and their franchise rights were assigned to the corporations. Plaintiff's completed the construction of two Judy's restaurants which commenced business operations during February and June of 1979. Both restaurants proved to be unprofitable and were closed in December of 1979 and October of 1980 respectively.

Thereafter, plaintiffs initiated this action in the federal district court charging the defendants with fraud, negligent misrepresentation, intentional failure to disclose vital business information, conspiracy, and breach of contract which caused substantial injury to the plaintiffs. At the conclusion of a three and one-half week trial, the jury

returned a verdict in favor of plaintiffs, having concluded that defendants had failed to disclose critical business information to the plaintiffs and had committed fraudulent concealment and constructive fraud. Defendants timely moved for a judgment notwithstanding the verdict or, in the alternative, a new trial. The court denied the motions and this appeal ensued.

Defendants' first assignment of error charged that the district court's submission of the issue of constructive fraud to the jury was improper. Defendants argued that an action for constructive fraud could be maintained only upon proof of a confidential relationship between plaintiff and defendant and that, as a matter of law, the facts of the case did not give rise to such a relationship. This assignment of error is disposed of by *Edwards v. Travelers Insurance Company of Hartford, Connecticut*, 563 F.2d 105, 114 (6th Cir. 1977) wherein this circuit reviewed the Tennessee law of constructive fraud and observed:

> A definition of constructive fraud was given in *Maxwell v. Land Developers, Inc.*, 485 S.W. 2d 869, 875 (Tenn. App.), *cert. denied*, (1972).
>
> > "Constructive frauds are acts, statements or omissions, which operate as virtual frauds on individuals, or which, if generally permitted, would be prejudicial to the public welfare, and are not clearly resolvable into mere accident or mistake, and yet may have been unconnected with any selfish evil design, or may amount, in the opinion of the person chargeable therewith, to nothing more than what is justifiable or allowable." Gibson's Suits in Chancery 5th Ed. Vol. II, § 982, p. 217. Constructive fraud may be established where there is a breach of legal or equitable duty, whether or not fraudulent intent be present. *Bank of Blount County v. Dunn*, (1929) 10 Tenn. App. 95.

> Failure to disclose thus becomes fraudulent when it is the duty of a party having the knowledge to reveal the facts to the other party. *Domestic Serving Machine v. Jackson*, 83 Tenn. 418, 424-25 (1885); *Dozier v. Hawthorne Development Co., supra*, 37 Tenn. App. 279, 262 S.W. 2d 705; *Georgia Marble Co. v. Standard Tile Co., supra*, 19 Tenn. App. 258, 86 S.W. 2d at 432.

The *Edwards* court went on to conclude that the "duty" to disclose known facts arises when there exists a "confidential relationship", which the court defined as:

> one in which "confidence is placed by one in the other and the recipient of that confidence is the dominant personality, with the ability, because of the confidence, to influence and exercise dominion over the weaker or dominated party." *Iacometti v. Frassinelli*, 494 S.W. 2d 496, 499 (Tenn. App.), *cert. denied* (Tenn. 1973).

In light of this circuit's pronouncements in *Edwards v. Travelers Insurance Co. of Hartford, Connecticut*, this court concludes that the trial court properly submitted the issue of the defendant's duty to disclose material business information to the plaintiff franchisees to the jury for disposition. Moreover, a review of the record disclosed that sufficient probative evidence supported the jury's decision that a relationship of confidence existed between the parties that required Judy's to disclose material facts that impacted upon the current and future viability of its entire franchising and business operations and the interrelated business operations of its individual franchisees which Judy's intentionally failed to do.

Defendants also asserted that the district court's refusal to grant a remittitur to reduce the jury's award of punitive damages was error because the award was excessive and disproportionate to the injuries suffered by the plaintiff. It should initially be noted that this circuit

has long adhered to the view that where, as here, a damage award has been determined by the jury and left undisturbed by the trial court, the award bears a presumption of correctness. As this court noted in *Manning v. Altec, Inc.*, 488 F.2d 127 (6th Cir. 1973):

> Where the jury finds a particular quantum of damages and the trial court refuses to disturb its findings on the motion for a new trial, the two factors press in the same direction, and an appellate court should be certain indeed that the award is contrary to all reason before it orders a remittitur or a new trial.

488 F.2d at 133 (quoting *Taylor v. Washington Terminal Company*, 409 F.2d 145, 148 (D.C. Cir.) *cert. denied*, 396 U.S. 835 (1969)). *See also Cathey v. Johns-Manville Sales Corp.*, 776 F.2d 1565, 1572 (6th Cir. 1985).

Moreover, while defendants argued that plaintiffs failed to prove a reasonable relationship between the punitive damages and actual injury, Tennessee has never adopted the reasonable relationship test. Instead, Tennessee courts have ruled that punitive damages "are allowed as punishment of the wrongdoer and are not based so much upon the nature and extent of the injury as they are upon the oppression of the party who does the injury." *Lazenby v. Universal Underwriters Insurance Co.*, 214 Tenn. 639, 642, 383 S.W.2d 1, 4 (1964); *Johnson v. Husky Industries, Inc.*, 536 F.2d 645, 650 (6th Cir. 1976); *Cathey v. Johns-Manville, supra.*

Viewing the evidence under the aforementioned standards, this court is constrained to conclude that the punitive damage awards were not "contrary to all reason." *Manning v. Altec, Inc., supra.* The Tennessee Supreme Court has recently directed that in assessing the reasonableness of awarded punitive damage consideration should be given to the egregiousness of a defendant's acts and the financial worth of the defendant. "The more repre-

hensible the act, the greater the award of punitive damages," *Coppinger Color Lab, Inc. v. Nixon*, 698 S.W. 2d 72, 75 (Tenn. 1985). Defendants' acts in the instant case were certainly egregious and the punitive damages award, when viewed against defendants' aggregate net worth of over thirty-seven million dollars, was not excessive.

This court having reviewed the defendants remaining assignments of error concludes that they are not well taken. For the foregoing reasons, the decision of the district court is AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 85-5527

A&B FOOD SERVICES CORPORATION, *et al.*,
Plaintiffs-Appellees,

v.

JUDY'S FOODS, INC., *et al.*,
Defendants-Appellants

[Filed Aug. 4, 1986]

Before: KRUPANSKY and GUY, *Circuit Judges*, and HOLSCHUH* *U.S. District Judge*

ORDER

The Court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this Court, and no judge of this Court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition

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* Hon. John D. Holschuh sitting by designation from the Southern District of Ohio.

were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/ John P. Hehman
JOHN P. HEHMAN
Clerk